

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL OF THE MANTSOPA LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mantsopa Local Municipality set out on pages x to x, which comprise the statement of financial position as at 30 June 2014, the statements of financial performance, changes in net assets, cash flows, statement of comparison of budget and actual amounts, and appropriation statement for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment of R679 030 174 (2013: R670 378 140), as disclosed in note 13 to the financial statements, as the municipality did not provide me with documentation and evidence to support the values of assets recorded in the asset register and evidence that all assets were accounted for as outlined in the requirements of SA Standards of GRAP, GRAP 17, *Property, plant and equipment* and SA Standards of GRAP, GRAP 26, *Impairment of cash-generating assets*. I was not able to determine the correct net carrying amount of property, plant and equipment as it was impracticable to do so due to inadequate descriptions, classifications and locations recorded in the asset register to facilitate physical verification and condition assessment of the assets. In addition, assets were identified that were not included in the asset register. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amount disclosed for property, plant and equipment.

Depreciation and amortisation

5. I was unable to obtain sufficient appropriate audit evidence regarding depreciation and amortisation due to the limitation placed on my audit of property, plant and equipment. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to depreciation and amortisation stated at R23 794 813 (2013: R23 787 301) in note 35 to the financial statements were necessary.

Investment property

6. I was unable to obtain sufficient appropriate audit evidence for investment property of R27 271 000 (2013: R27 271 000), as disclosed in note 12 to the financial statements, as the municipality did not provide me with documentation and evidence to substantiate the values recorded in the investment property register and evidence that all the assets were accounted for. In addition, the municipality did not determine the fair value of all investment properties as required by SA Standards of GRAP, GRAP 16, *Investment property* due to adequate controls not being implemented to perform the fair value evaluation. I was unable to determine the fair values of these investment properties as it was impracticable to do so. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for investment property.

Receivables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence to determine whether the debtors recorded by the municipality actually owe the amounts disclosed as trade receivables at R36 920 752 (2013: R54 949 765) in note 9 to the financial statements as documentation and evidence to verify this could not be obtained. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for receivables from exchange transactions.
8. The municipality did not make all the disclosures as required by the SA Standard of GRAP, GRAP 104, *Financial instruments*, which states that a municipality shall disclose by class of financial instrument information about the credit quality of financial assets that are neither past due nor impaired, the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated, an analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired and an analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired. I have not determined the correct disclosures of these receivables as it was impracticable to do so.

Receivable from non-exchange transactions

9. I was unable to obtain sufficient appropriate audit evidence to determine whether the debtors recorded by the municipality in the prior year as sundry debtors and disclosed in note 8 to the financial statements amounting to R1 077 780 actually owe the municipality as the municipality did not provide me with documentation and evidence to substantiate the value. I was unable to confirm the amount of these debtors by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for sundry debtors in the prior year.

Service charges

10. The municipality did not have adequate systems in place to correctly account for revenue from services provided and in some instances consumers were not charged for all the services rendered. The municipality also recognised revenue that was earned in the prior year, during the current year; I was unable to quantify the amount as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus. Furthermore, the municipality does not have an adequate system of internal control over year end estimations as I was not provided with sufficient appropriate audit evidence regarding service charge estimates calculated at year end. I was unable to confirm the service charges by alternative means. Consequently, I was unable to determine whether any adjustments to service charges stated at R89 713 659 (2013: R92 679 596) as disclosed in note 23 to the financial statements were necessary.

Interest received – outstanding debtors

11. The municipality did not charge the correct interest rates in accordance with the approved credit policy on outstanding debtors resulting in the understatement of the interest received disclosed at R18 869 495 (2013: R16 046 032) in the financial statements. I was unable to quantify the error as it was impractical to do so due to the aging of the outstanding debtors and timing of interest charges.

Government grants and subsidies

12. I was unable to obtain sufficient appropriate audit evidence that all revenue from grants income was recognised in the statement of financial performance due to an inadequate system of internal control to account for revenue from grants. Furthermore, I could not confirm whether all grants revenue had been accurately recognised as documentation and evidence to substantiate journals passed could not be provided to me. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether adjustments to the amount of the government grants and subsidies stated at R101 784 588 (2013: R106 242 032) in note 27 to the financial statements were necessary.

Payables from exchange transactions

13. I was unable to obtain sufficient appropriate audit evidence for payables due to an inadequate system of internal control to account for payables. Furthermore, I could not confirm that all related expenditure has been correctly recorded as invoices received before year-end had not been provided for as payables. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments to the payables amount stated at R50 089 421 (2013: R47 946 290) in note 18 to the financial statements were necessary.

Accumulated surplus

14. I was unable to obtain sufficient appropriate audit evidence to substantiate the amount disclosed as accumulated surplus at R642 124 895 (2013: R650 190 667) in the statement of financial position and in the statement of changes in net assets due to supporting documentation and evidence that could not be obtained for the movement in the balance of the prior year corrections and opening balance. The municipality's records and information available did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustments relating to accumulated surplus in the financial statements were necessary.

Expenditure

15. I was unable to obtain sufficient appropriate audit evidence that invoices were properly recorded and accounted as documentation and evidence were not provided to me. I was also unable to obtain documentation and evidence that journals passed were appropriate and necessary. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to expenditure stated at R208 867 496 (2013: R297 596 846) in the financial statements were necessary.

Employee-related cost

16. I was unable to obtain sufficient appropriate audit evidence for the comparative employee-related cost disclosed at R52 538 888 in the statement of financial performance and note 32 to the financial statements due to supporting documentation that could not be obtained for payments made amounting to R3 909 997 with regards to car allowances, overtime and journals. The municipality's records and information available did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustment relating to employee-related costs in the financial statements was necessary.

Irregular expenditure

17. The municipality did not include all particulars of irregular expenditure in the notes to the financial statements as required by section 125(2)(d)(i) of the MFMA for the current year as the controls over the system were ineffective and management did not review the entire population to ensure that all instances of irregular expenditure were identified and recorded. I was unable to determine the full amount of the misstatement irregular expenditure as it was impracticable to do so.

Fruitless and wasteful expenditure

18. The municipality did not include particulars of all fruitless and wasteful expenditure in the notes to the financial statements as required by section 125(2)(d)(i) of the MFMA as penalties charged on late payments and submission of VAT returns as well as other expenditure made in vain were not included in the register of fruitless and wasteful expenditure. I was unable to determine the full amount of the misstatement of fruitless and wasteful expenditure as management did not go back to the whole population to identify other instances of fruitless and wasteful expenditure.

Distribution losses and free services

19. Section 125(2)(d)(i) of the MFMA requires that the financial statements of a municipality must disclose particulars of any material losses. The municipality has incorrectly calculated and disclosed the distribution losses or free services provided disclosed as R13 281 814 (2013: R7 729 385) for water and R3 680 508 (2013 R 15 437 232) for electricity in note 54. This is due to the use of incorrect and unverifiable data in the calculation of the losses to support the information as disclosed in the financial statements. In the absence of sufficient appropriate documents, I was unable to determine the total extent of the misstatement in distribution losses and free services provided.

Leases

20. The municipality did not classify lease agreements as finance leases where substantially all the risks and rewards incidental to ownership were transferred to the entity in accordance with SA Standards of GRAP, GRAP 13, *Leases* as the municipality incorrectly interpreted the requirements of the standard. The prior period errors as disclosed in note 47 to the financial statements are therefore inaccurate. The incorrect classification has a misstatement effect on other related accounts.

Commitments

21. The municipality did not have adequate systems in place to properly account for contractual commitments as required by SA Standards of GRAP, GRAP 1, *Presentation and of financial statements* at year-end, which resulted in commitments as disclosed in note 44 to the financial statements being misstated. In addition, I was unable to obtain sufficient appropriate audit evidence regarding commitments due to an inadequate contract management system and an incomplete and inaccurate contract register. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments relating to commitments stated at R63 270 535 (2013: R51 945 835) were necessary.

Cash flow statement

22. I was unable to obtain sufficient appropriate audit evidence to determine whether the cash flow statement and the related notes were fairly stated for the current and prior year. Taking into account the misstatements and scope limitations identified in the financial statements, as set out in this report, I was unable to practically quantify the misstatements in the cash flow statement and notes thereto. Consequently, I was unable to determine all disclosures were correctly made in the cash flow statement and related notes.

Changes in accounting policy

23. The municipality did not disclose the effects of the change in accounting policy for the standards adopted in the current year as outlined in note 2 to the financial statements in accordance with SA Standards of GRAP, GRAP 3, *Accounting policies, changes in accounting estimates and errors*. I was unable to practically quantify the effect by other means.

Contingencies

24. I was unable to obtain sufficient appropriate audit evidence to determine whether the municipality has disclosed all contingent liabilities in accordance with the SA Standards of GRAP 19, *Provisions, contingent liabilities and contingent assets*. This was due to the municipality's attorney denying me access to the records of the municipality. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments relating to contingent liabilities stated at R10 605 580 (2013: R4 289 687) were necessary.

The municipality did not disclosed for each class of contingent liability at the reporting date a brief description of its financial effect, an indication of the uncertainties relating to the amount or timing of any outflow; and the possibility of any reimbursement in note 45 to the financial statements as required by SA Standards of GRAP 19, *Provisions, Contingent liabilities and contingent assets*.

VAT payables

25. I was unable to obtain sufficient appropriate audit evidence for VAT payables disclosed as R14 411 800 (2013: R14 677 375) in note 19 of the financial statements due to an inadequate system of internal control to account for VAT payables. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the amounts disclosed for VAT payables.

Disclaimer of opinion

26. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

27. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

28. The municipality has restated comparative figures due to errors discovered during the current financial period; however the actual restatements of comparative figures have not been disclosed in note 48 to the financial statements.

Impairments

29. As disclosed in note 9 to the financial statements at R208 598 198 (2013: R159 598 634), there is a significant impairment of debtors due to poor collection practices at the municipality. The debtors impairment increased by R48 773 392 in the current year (2013: R95 996 677) as disclosed in note 38 to the financial statements.

Material underspending of the conditional grant

30. As disclosed in note 20 to the financial statements, the EEDG and COGTA conditional grants were materially underspent by the municipality. The amount unspent as at 30 June 2014 was R5 729 080 (2013: R799 866).

Statement of comparison of budget and actual amounts

31. The municipality did not disclose reasons for the differences between the final approved budget and the actual amounts for the current year. Consequently, I was unable to determine the reasonableness of the over and underspending on votes.

Unauthorised expenditure

32. As disclosed in note 51 the municipality is currently investigating further expenses that could be found to be unauthorised expenditure. Instances of over and underspending on budgeted votes were identified on the overall the municipality did not overspend the final approved budget.

Going concern

33. As disclosed in note 58 to the financial statements, the municipality is experiencing financial difficulties as current liabilities exceed current assets, consumer debtors are not recovered timeously and the inability to settle accounts payable within an acceptable period. The negative effect of this tendency on the cash flows of the municipality indicate that there is a risk that the municipality may be exposed to financial difficulties in terms of section 138 of the MFMA. Furthermore, the existence of these conditions indicates material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Additional matter

34. I draw attention to the matter below. My opinion is not modified in respect of this matter

Unaudited supplementary information

35. The supplementary information set out on pages [xx] to [xx] does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

36. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the local municipality for the year ended 30 June 2014:
- Development Priority 1: Water provision on pages x to x
 - Development Priority 2: Sanitation provision on pages x to x
 - Development Priority 3: Electricity provision on pages x to x
 - Development Priority 4: Roads and storm water on pages x to x
 - Development Priority 5: Solid waste management on pages x to x
 - Development Priority 6: Housing and land - housing on pages x to x
37. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
38. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting

principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

39. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
40. The material findings in respect of the selected development priorities are as follows:

Development Priority 6: Housing and land – housing

Reliability of reported performance information

41. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.
42. I did not raise any material findings on the usefulness and reliability of the reported performance information for development priority 1: water provision, development priority 2: sanitation provision, development priority 3: electricity provision, development priority 4: roads and storm water, development priority 5: solid waste management.

Additional matters

43. I draw attention to the following matters:

Achievement of planned targets

44. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs x to xx of this report.

Adjustment of material misstatements

45. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for development priority 1: water provision, development priority 2: sanitation provision, development priority 3: electricity provision, development priority 4: roads and storm water, development priority 5: solid waste management and development priority 6: housing and land - housing. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness of the reported performance information. As management subsequently corrected only some of the misstatements, I raised material findings on the reliability of the reported performance information.

Unaudited supplementary schedules

46. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with laws and regulations

47. Included below are material findings of non-compliance with specific requirements in key applicable laws and regulations.

Liability Management

48. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) / 96(2)(a) of the Municipal Finance Management Act.

Annual financial statements, performance and annual report

49. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
50. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013/14 annual report was tabled, as required by section 129(1) of the Municipal Finance Management Act.

Expenditure Management

51. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) / 99(2)(b) of the Municipal Finance Management Act
52. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) / 95(d) of the Municipal Finance Management Act
53. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) / 99(2)(a) of the Municipal Finance Management Act.

Transfer of funds and/or unconditional grants

54. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant allocation, as required by section 12(5) of the Division of Revenue Act.

Revenue Management

55. An effective system of internal control for revenue was not in place, as required by section 64(2) (f) / 97(e) of the Municipal Finance Management Act.

Asset Management

56. An effective system of internal control for assets was not in place, as required by section 63(2)(c) / 96(2)(b) of the Municipal Finance Management Act.
57. An adequate management, accounting and information system which accounts for assets was not in place, as required by section [63(2)(a) / 96(2)(a)] of the Municipal Finance Management Act

Investments

58. All investments were not made in accordance with the requirements of the investment policy, as required by Municipal investment regulation 3(3).

Consequence management

59. Unauthorised, irregular, fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) /102(1) of the Municipal Finance Management Act.

Procurement and contract management

60. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
61. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
62. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
63. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
64. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

Strategic planning and performance management

65. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).

Internal control

66. I considered internal control relevant to my audit of the financial statements, the service delivery performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the service delivery performance report and the findings on compliance with laws and regulations included in this report.

Leadership

67. The effective implementation of internal controls was not evaluated by gaining an understanding of how senior management members had met their responsibilities in terms of preparing timeous reconciliations, ensuring proper records management, maintaining an adequate asset register and preparing the annual financial statements.
68. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evidenced by the failure of management to adequately address the external audit findings in a timely manner.

69. Leadership did not exercise effective oversight in the implementation of recommendations made by internal and external auditors thus resulting in repeat audit findings and non-compliance issues.

Financial and performance management

70. The municipality did not always comply with applicable laws and regulations. In most instances, there were no formal processes in place to monitor compliance with legislation, which resulted in the number of reported non-compliance issues. There was also a lack of consequences for poor performance or where laws and regulations were not complied with.
71. The monitoring and implementation of the municipality's action plan on prior year audit findings was not effective at all times. The staff within the finance directorate of the municipality not having sufficient understanding of the accounting framework, contributed to the errors that were subsequently corrected in the financial statements of the municipality.
72. The municipality did not affect proper record keeping ensuring that complete, relevant and accurate information was accessible and available to support financial information reported mainly due to the fact that responsible personnel did not continuously perform control activities in a timely manner as defined by policies and procedures due to a lack of consequences.
73. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in number of findings relating to incorrect disclosure or non-disclosure according to GRAP.
74. The accounting system could not timeously produce credible, verifiable and reliable financial and performance information.

Governance

75. The financial statements contained numerous inaccuracies, which are attributable to weaknesses in the design and implementation of internal control in respect of financial management and financial reporting, and weaknesses in the information systems.
76. The implementation of internal and external audit recommendations was not monitored. This resulted in a number of prior year audit findings not being substantially addressed.

Bloemfontein

AUDITOR - GENERAL

30 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence